

**COMMONWEALTH OF MASSACHUSETTS  
DEPARTMENT OF PUBLIC UTILITIES**

<b>Investigation by the Department of Public Utilities</b>	)	
<b>upon its own motion commencing a Notice of Inquiry/</b>	)	
<b>Rulemaking, pursuant to 220 C.M.R. §§ 2.00 <u>et seq.</u>,</b>	)	<b>D.P.U. 96-100</b>
<b>establishing the procedures to be followed in</b>	)	
<b>electric industry restructuring</b>	)	
<b>by electric companies subject to G.L. c.164</b>	)	

**COMMENTS OF  
THE DIVISION OF ENERGY RESOURCES  
ON  
PROPOSED RESTRUCTURING PLANS**

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April 12, 1996

**(CORRECTED)**

**Question 1. Of the restructuring plans filed, which offers customers "the broadest possible customer choice" (DPU Principle 1) and provides "all customers with an opportunity to share in the benefits of increased competition" (DPU Principle 2)?**

The plans filed by DOER, EUA, MECo and BECo contemplate customers from all classes exercising choice of competitive suppliers and receiving delivery of power under terms specified in bi-lateral contracts. However, the plans differ dramatically in how they serve the needs of customers who do not select a competitive supplier or who prefer spot market power. DOER believes there will be many customers among these two groups.

Given the experience with deregulation in other industries, it is reasonable to assume that, at the outset, and for some years into the future, there will be many "passive" customers who are not interested in choosing among competitive generation suppliers. We can reasonably assume that this may well be a substantial majority of customers in the early years and a significant minority of customers in later years. In addition, there will always be "transitional" customers who must receive power when their generation supplier either temporarily or permanently fails to deliver the full amount of their power requirements.<sup>1</sup> Furthermore, there will also be customers who want to contract for only a portion of their electrical load and purchase the balance of their needs (e.g., supplemental or peaking) on the spot market.<sup>2</sup>

BECO's plan appears to recognize the potential need to serve these different

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<sup>1</sup> Easy access to spot-priced service is essential to prevent and remedy red-lining or any other form of discrimination or lack of access to a reliable electric supply. Basic service should also be available to any customers whose retailers terminate contracts for non-payment so that any physical shut-offs are only administered by Distribution Companies ("Discos") under Department regulation.

<sup>2</sup> Without such access, such customers would be subject to attempts by Distribution Companies and any affiliated generation or retailing entities to extract excess value from the customers for providing, arranging or settling these imbalances.

customer needs. Its Phase I would provide all generation at a "simulated" spot price (through a computerized projection that all will admit is a less-than-reliable substitute for a market price).

BEC's Phase II unfortunately reverts to a "standard offer" structure similar to those proposed by MECo and EUA. Under this "standard offer", passive customers would find themselves assigned to a contract with an unregulated affiliate of the Distribution Company under contract-like terms they must take affirmative steps to avoid. The problem with this, of course, is that the notion of providing a real market price to the customers listed above is lost and replaced by a formula-driven price cap. While that price may fluctuate due to "exogenous" factors in the formula, it does not fluctuate based on market forces of supply and demand.

MECo asserts that its proposed standard offer is "customer friendly and maximizes customer choice." DPU 96-25, Testimony of Sergel, p. 21, line 6. However, this "offer" is inherently threatening to customers, since it provides a service to which the customer, once departed, cannot return. That feature will have the effect of making customers fearful of leaving the utility and testing the competitive market. Any returning customers will be told that they are ineligible for the standard offer and must accept "safety net" service, which may be priced at a premium level. This would be a particularly troublesome solution for temporary inability to pay a chosen retailer.

It is difficult to see how the standard offer could maximize choice, especially since it primarily constitutes a security-blanket-type inducement not to choose a competitive supplier. It reinforces what may be customer fears of new retailers. For example, MECo raises the specter of choice being forced on an unwilling participant and "all customers forced to the market on a single day." Id., p. 19, line 10. There is widespread agreement that customers should not be forced to make choices, and **Power Choice's** Basic Service approach is a way to provide both choice and continuity,

without providing the incumbent utility with the assured market share that would result from its retention of many "standard" customers.

MECo also argues in favor of the standard offer that "some customers might believe that there are continued 'benefits' associated with bundled service." Id., p. 19, lines 5-6. No doubt some customers, for various reasons, will have this view, even though they would, in fact, become customers of an unregulated retail affiliate, rather than the Disco. The problem is that the standard offer rewards this preference for a familiar company with a price cap. Restructuring should be designed to rely on the competitive marketplace, not the incumbent utility, for the benefits of "rebundled" services of all kinds. Rather than characterizing as "maximum choice" a system which amounts to a continuation of the regulatory pact with a price cap, utilities should actually facilitate real choice by developing information systems to efficiently convey usage data to retailers, who can present their customers with whatever kinds of bundled invoices and services are desired by customers.

Finally, MECo describes its standard offer as an important service choice in the form of protection for passive customers against unexpectedly high market prices. This is also one of the services that will be offered by competitive retailers. By thus designing its standard offer explicitly "to be consistent with the prices likely to occur under continued regulation" Id., p. 32, line 19, the utility acts to dampen the level of demand for such services.

This does not maximize choice; rather, it minimizes the likely extent of choice. A better solution for passive customers, and a solution that would readily meet the needs of transitional and supplemental customers as well, would be to have a regulated affiliate of the Disco pass through electricity at the hourly spot price. This affiliate would be regulated not on a cost of service basis, but as to the nature, the efficiency and reliability with which it passes through the spot price. By providing a straight pass

through of a competitive market price, passive customers would receive competitive prices for generation. (Indeed, they will receive greater price reductions than they would under the "standard offer".)<sup>3</sup> Transitional and supplemental customers will receive competitive prices when, despite also having chosen a supplier they find themselves, needing additional power.

Furthermore, if the Disco was to be in a position to welcome back "returning" customers, these customers testing competitive suppliers would not need to fear being unable to obtain reasonably priced services if their tests proved unsatisfactory.<sup>4</sup>

The availability of the spot market price will have other beneficial impacts on the power choices available to all customers. For example, it will also help to equalize the access to market information between the small customers and the retailers offering contract pricing and services. It will be up to the retailers to offer genuine advantages in order to win these customers. This simple access to competitive spot market pricing will discipline the pricing behavior of those selling power on a contract basis and provide a mechanism for those sellers to dispose of excess power and obtain power required to service their contracts.<sup>5</sup>

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<sup>3</sup> It is likely that utilities will not be afraid of driving passive customers away. Utility "offers" are likely to start at above-market levels set to capture as much profit as the passive customer market will bear. The escalators built into the "standard offer" pricing in some of the filed utility plans suggest that the utilities are also leaving themselves ample room to charge above-market rates to passive customers in the future.

<sup>4</sup> We recommend that the Disco provide this access to the spot market on a brokerage basis rather than taking title to the power to assure that the Disco does not assume any unnecessary merchant risk. In order to facilitate regulatory review, we also recommend that the Disco establish a new wholly-owned corporate entity to separately account for any power so brokered, or bought and sold.

<sup>5</sup> In fact, many manufacturing customers and other energy users with on-site generation and/or computerized energy management systems with load management capability have a need

With the introduction of choice, it is inevitable that some form of a spot market will emerge in Massachusetts and New England. Regardless of the extent to which parties engage in bilateral contracting, once the pricing of generation has been deregulated in Massachusetts, large and small generators, retailers and load aggregators, will all need to trade imbalances. They will of necessity seek out supply aggregators, and other bulk and retail buyers to purchase their power on an hourly or other short-term basis. Many, if not all, suppliers will seek to sell spot power whenever their customers are not taking all economically-competitive energy. They will likewise seek to buy spot power whenever their capacity is not available to fully serve their load. Concurrently, many buyers will seek to buy spot power at all times when that power is available at a competitive price and their contracted supply is insufficient or unavailable. Over time, the most efficient types and sizes of spot markets will emerge.<sup>6</sup>

The spot market will have a substantial volume of transactions and aggressive price bidding by generation suppliers. It will be very competitive as long as horizontal market concentration among suppliers is prevented. While spot market prices fluctuate, it would be presumptuous not to assume that at least some buyers may find those fluctuations quite tolerable, even desirable. However, a large segment of passive,

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for assured access to peaking and supplemental supplies of power on a real-time basis, and a parallel need for an assured spot market into which to sell excess power.

<sup>6</sup> Some parties have raised the question how long it might take to achieve these new regional arrangements, and whether the rest of **Power Choice** is contingent on the ISO and the PX being in operation before retail choice and Basic Service could begin. While there should be no delay in the development of these new regional arrangements, there is no reason to make the introduction of other elements of **Power Choice** contingent on such changes in NEPOOL. In other words, any delays introduced in NEPOOL reform will not lead to delay if other provisions of **Power Choice** are implemented.

transitional and supplemental customers may not want (and, without meters, could not be given) hourly prices. The Disco can bill them by blending hourly fluctuations over a monthly billing cycle based on average load curves. In addition, even monthly fluctuations can be smoothed out by the Disco through arrangements for budget billing, with an appropriate fee for administering and financing this service.

Some parties may be concerned that spot prices will be “too high” during the initial years. They may assume that most generation would be sold on a bi-lateral contract basis, with only a portion of the generation “left over” for the spot market. This is a common misperception of the normal relationship between contract and spot markets. First, as we have noted above, a significant volume of transaction activity will inevitably flow through the spot market, due to factors such as imbalances and generator downtime, in addition to the Basic Service load. This level of activity should assure enough spot volume to keep prices within reasonable ranges over time.<sup>7</sup> More generally, the overall supply and demand levels in the New England market will govern price levels in the market as a whole. Within the New England market, contract volume would have to be very high in order for the “remaining” spot prices to be out of line.<sup>8</sup>

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<sup>7</sup> In Norway, prices are set in the spot market, with contract prices tracking spot prices, rather than the other way around. Professor Per Loken, remarks to the Massachusetts Restructuring Roundtable, January 22, 1996.

<sup>8</sup> Likewise, the spot market price by definition performs the function of bringing demand into balance with supply, so the model of needing to “match” bilateral customers with “enough” MW of generating capacity is not an accurate model of market dynamics. Some have expressed concern that in those few hours of the year in which the electricity market is tightest (due to high demand or low supply), the spot market might “run out” of energy to be purchased at any price. There are three primary reasons that such a risk is negligible.

It is reasonable to expect that spot prices will be equivalent to prices in the contract markets over time (e.g., other than volatility hour-to-hour). Any disparities will not last long in a deregulated market. Generators may be willing to offer an attractive price to customers to get a secure stream of future revenue, but they will not keep signing contracts at prices lower than what they could get in the spot market. Also, customers who contract in order to hedge market volatility will be willing to pay a premium over expected spot prices for this value.

The spot market will not “run out even in tight conditions.” First, the reliability of the region’s grid must not and will not be threatened by any restructuring proposal. **Power Choice** vests an Independent System Operator (ISO) with full responsibility for regional reliability.<sup>9</sup> Second, at times of such market tightness and high spot prices, the economic value of peak shaving will be high enough to trigger computer-managed or other voluntary demand reductions in amounts much greater than at present. Third, during the early years of the transition to competition, any potential risks associated with shifting to new systems will be offset by the current surplus of capacity in the region. This surplus will preclude shortfalls of power.<sup>10</sup>

**Question 2: Of the restructuring plans filed, which offer a substantial likelihood of assuring near-term and long-term rate relief (DPU Transition Principal 3)? Which provide mitigation of stranded costs (DPU Transition Principal 1)?**

None of the utility plans offer a realistic prospect of near term rate relief or substantial mitigation of stranded costs. This is primarily because they do not provide

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<sup>9</sup> Methods through which the ISO could assure reliability include executing call contracts for capacity to be available for such tight periods, or requiring all generators or wholesale buyers to maintain a specified level of operating reserves, which could lead to trading of such reserves. One or both types of reserves would be available to supply the regional spot market, since they would represent capacity over and above that which is under bilateral contracts with buyers.

<sup>10</sup> Another factor limiting potential shortfalls is the potential use of transition contracts under which Distribution Companies may retain the ability to call on their formerly affiliated generating capacity to provide Basic Service.



for market valuation of stranded costs and thus do not fully mitigate those costs. Most of the plans fail to reflect any market value of their generation assets in their stranded cost estimates. EUA's plan seeks to retain fossil generation assets for EUA and withholds them from net valuation and mitigation. Only Com/Elec among the utilities recognized that market valuation was the best way to achieve mitigation. While every utility submitted volumes on their rights to recover uneconomic generation, hardly a word was offered on how they would compensate ratepayers for the opportunity to earn future profits with the assets they retain.

MECo's plan offers only limited mitigation. MECo's proposed "termination charge" appropriately excludes variable costs "associated with continued operation of NEP's units." Id., p. 36, line 13. However, DOER does not regard these as stranded costs in the first place. Excluding non-stranded costs from access charges is not mitigation. MECo also claims that its proposed "standard offer" would "reflect a credit for the market or residual value of the plants" that MECo's affiliates propose to retain. Id., p. 37, lines 3-4. However, this constitutes neither mitigation nor market valuation.

MECo implies in support of its standard offer proposal that it should be considered a form of mitigation of stranded cost, since it offers the customer something of value in the form of future price security. While price security may have value to some customers, it is not mitigation. Standard offers don't lower stranded cost payments. Neither do they provide rate relief.<sup>11</sup> To the extent price certainty is viewed as a benefit and delivered to standard offer customers, it is an inequitably distributed benefit. Only customers staying with MECo for generation service receive it. The

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<sup>11</sup> MECo proposes to begin its standard offer at current prices, escalate it with inflation and pass through various "extraordinary" costs. MECo only argues that the standard offer provides rate security, not a rate reduction.

standard offer product is actually a competitive offering which should be offered by non-affiliated competitors.

Neither does the standard offer provide a market valuation. NEES implicitly recognizes that its generation assets have market value. Its claim that its standard offer provides value in exchange for this residual value is indeed an attempt to approximate this value. However, NEES's claims to value are neither measurable, competitively determined, nor used for mitigation of stranded costs. Essentially, the NEES methodology of recovering all the book value of NEP generating assets in its termination charge drives up the access charge to the disadvantage of all ratepayers. To the extent revenue from that charge cross-subsidizes some of the costs that MECo-affiliated suppliers would otherwise seek to recover from the market, it would have the anti-competitive effect of allowing NEES to undercut non-affiliated supplier prices for reasons other than lower marginal costs.

**Most of the utility plans also inflate stranded cost estimates by using inappropriate price forecasts. For example, the market price estimates on which MECo and WMEC based their plans do not reflect the nature of market conditions that will exist after deregulation of generation pricing. Market prices at the outset of a deregulated market for generation will be based on different factors than those which drive the current market for bulk power trades by utilities under cost of service regulation. To the extent that these utility plans fail to provide for genuine deregulation of prices and interfere with the emergence of a genuine market for power, they could cause artificially depressed wholesale prices for some early years in the transition.<sup>12</sup> Such delays and interference would likely be converted into**

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<sup>12</sup> The primary reason why today's bulk power market prices are lower than the going-forward costs of most of the region's generating plants is that most O&M costs and capacity additions are paid for by ratepayers on a cost-of-service basis.

artificially high levels of stranded cost recovery.

Market valuation is the only practical and reliable way to determine, mitigate and minimize the amount of stranded costs, and is, therefore, the key to achieving near-term rate relief. The only way restructuring can achieve near term rate relief is by tapping all "above-book" utility assets and revenue-producing opportunities for mitigation of commitments made potentially uneconomic by competition.

There is large potential for mitigation available in utility retail and generation assets which should be captured to mitigate stranded costs and to lower prices. New entrants and other participants in competitive markets will place substantial value on the retail assets, as well as generation assets, that utilities have developed during the period in which they were regulated monopolies. Capturing the strategic value in future retail markets of utility assets will reduce "stranded costs" much more than has been generally realized.

Utility shareholders stand to gain great value from the new opportunities afforded their companies in the retail marketplace. Utilities enter these new competitive markets with tremendous resources and competitive advantages, all obtained through their operation as a regulated utility. For example, utilities have name recognition and a reputation for providing reliable service. Utilities have special knowledge of their customers -- their needs, their usage of electricity and other fuels, their payment histories, their participation in ratepayer supported programs. Utilities have special access to their customers -- their monthly billing, their service to their premises, their responsibility for product safety, their meter reading. Utilities have an existing customer relationship with every single potential

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Therefore, wholesale trades at the margin only reflect the incremental cost of fuel (and very small levels of variable O&M).

retail customer in their service territory. The retail function should take with it any customer contracts that are still in effect; the market valuation of the retail business will then capture this value as well in lower access charges. The retail affiliates position in these markets will have great value. Furthermore, affiliated retailers will not be restricted to electricity, energy nor energy services. Whatever services can be delivered efficiently and at a profit are available for pursuit.<sup>13</sup> It seems every day we hear another announcement of a utility's plan for a competitive business to exploit these resources. DOER recommends that this value be used as mitigation, up to the amount determined eligible for stranded cost recovery.

Developed generation sites have value for future generation. The existing sites have fully developed infrastructures for fuel, transportation and connections to the transmission system. These sites and any undeveloped land owned by utilities include premium locations for new or expanded generation and potentially other development.

*Market valuation of each utility's generation business as a unified going concern will likely yield even higher values than the values of assets sold separately. Every generating business unit has an infrastructure support group made up of people skilled in fuel procurement, operation, maintenance, engineering, administration, etc. Individually and as a group they may represent valuable assets of the generating company and they bring experience and know-how specific to these particular generating units. There may well be certain synergies reflected in the*

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<sup>13</sup> On April 4, Central and South West won approval from the FCC to be the first electric utility to enter the telecommunications business under the new telecommunications law. Central and South West said it could eventually offer cable-TV, phone, electronic banking, Internet access and other services over its own fiber optic lines, or lease spare space on the lines to other telecommunications companies. NYT. April 5, 1996.

*ownership of a particular portfolio of generators which increases their value over their separate valuations. There are certain economies of scale of operation which are obtained by operating multiple units and there may be particular generation services or pricing terms better provided by a certain mix of units. Market value may also be enhanced by combining some or all generation and retail assets in entities to be spun-off.*

*There is no more reliable way to assure the mitigation of stranded costs than to seek revenue from buyers that most highly value the assets and opportunities they afford. It is essential to mitigate stranded costs if restructuring is to produce near-term rate relief. The best way this can be done is by applying a rigorous market test.<sup>14</sup> It is generally agreed that a market test is the most, if not only, accurate way to value assets. The transaction costs associated with market valuation are dwarfed by the present value of future regulatory costs avoided by the separation of ownership (discussed below). For those utilities that proposed to estimate stranded costs on the assumption of a zero market value for their generating assets, every dollar of market valuation will result in rate reduction to customers. The larger the amount of mitigation, the lower the level of stranded costs which would be collected by the access fee and thus the greater the amount of rate relief.*

*Some reviewers have feared that a poorly designed market valuation process could lead to the sale of generating assets at low values and thus have the unintended result of increasing stranded cost charges. However, such an outcome is most unlikely since there are many factors which will drive market valuations of generation assets higher than would be expected based solely on prices of today's wholesale transactions. First, realistic expectations of the future market prices of wholesale power will support significant market values for generation assets. Once generation pricing is deregulated, prices at the margin will generally reflect most going-forward costs of generation, many of which are recovered in today's cost-of-service rates and do not need to be recovered now from any sales of surplus, economy energy. Significant expected revenues mean significant asset valuations by the market. Second, aggressive competitors will likely increase the market value of generation assets. There is a widespread expectation that competing generators and retailers of electricity will aggressively try to establish themselves in Massachusetts as soon as the rules become clear for implementing customer choice by January, 1998. These competitors will drive up the value of existing generation businesses and assets. Third, the regional surplus of power may last long enough to keep prices low at the outset of competition, but will be too short-lived to significantly depress the market value of generating*

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<sup>14</sup> However, there are a number of ways to determine a market value. We note, for example, this can include sale by auction or by a stock valuation after a spin-off.

units. The current surplus, driven by regulatory incentives and recession, will not last long in the face of economic growth. In any event, plant retirements due to deregulation of generation pricing will eliminate any surplus and bring the market into equilibrium. In addition, imports are too restricted to significantly reduce New England market prices.

Fourth, auctions can and should be designed to avoid any glut of generation assets for sale. Moreover, spinoffs with stock valuation should not be as sensitive to the volume of valuation activity. It is unlikely that all utilities would divest or spinoff such assets at the same time. In any event this can be reinforced by allowing an adequate period of time (say through 2000) and a procedure to assure that sales are spread out over the period to avoid a "glut" of power plant assets being sold on the market all at once.

In summary, the market prices of generation supplies are expected to be sufficient to support a positive market value for many plants, and the demand for market share in Massachusetts is high among potential competitors. The results of a properly-designed market valuation process will be a significant reduction in transition charges for stranded cost recovery and significant rate relief.

Question 3:

Which plan "ensures full and fair competition in generation markets" (DPU Principle 3)?

Full separation of ownership is needed to prevent the exercise of vertical monopoly power by Discos. Otherwise, there will be barriers to entry and prices will be too high. Even the perception of the potential for the incumbent utilities to unfairly dominate the market will chill the willingness of new competitors to enter the market. Only if Discos are fully independent will new retailers be encouraged to enter the market and compete with the generation and retail companies formed out of today's utilities.

While all the utility-filed plans propose "functional separation" of generation, transmission and distribution functions, they all fall short of offering "full and fair competition" required by the DPU Principles. Competition should be the key focus of all restructuring activity, because it is the primary means through which prices can be driven to the lowest possible levels. Some of the utility plans offer separation of competitive businesses into distinct corporations: some regulated, the others unregulated, all under the same ownership. However, this corporate separation does nothing to diminish the incentive for a rational, profit-maximizing Disco to engage in anti-competitive behavior by, for example, providing favored access to retail or generation affiliates or by maintaining obstacles to information or distribution access to its competitors. Only Power Choice removes this barrier to competition by providing for full, voluntary separation of ownership between the Disco and any competitive businesses. This is not a matter of seeking perfection. Rather, full competition is the only way to assure that all customers receive the greatest possible rate reductions.

The utility plans do not provide any indication that keeping a corporate affiliation will benefit ratepayers, with the exception of the MECo argument that the standard offer will provide customers with a degree of security against future price increases.

Generation affiliates are not the only affiliates that a Disco could seek to favor.<sup>15</sup> In fact, there may be even greater profit potential in dealing with retail affiliates. This would also be more difficult to police, as it would require dealing with unregulated industries (such as fuel oil, computer and video access services and the like) with which the Department may be less familiar and which are in any event rapidly changing.

If Discos retain unregulated affiliates, they could also make available to their affiliates non-comparable terms and conditions that could be difficult to trace. The provision of distribution service could be used to favor affiliates in the provision of such necessary services as allocating distribution losses, reporting meter readings, measuring and settling imbalances between different suppliers and the spot service arranged by the Disco, calculating residual load shapes, charging for new service hookups, allocating among customers or regions those DSM or other customer service functions retained by the monopoly and so on. It is not necessary for a Disco to provide particular favors directly to its affiliate to disrupt the market; it would also benefit from actions that simply bog down market entry, since its affiliates are already in the

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<sup>15</sup> The indication made by COM/Electric that it may divest itself of its generation contracts is the utility proposal that holds the most promise of dealing with vertical market power associated with generation, but does not appear to address the potential for anti-competitive behavior with respect to the retail functions.

market.

*The most potent anti-competitive lever may be the use of information, such as the case of a Disco informally notifying its affiliate of a potential customer sales opportunity or threat. Furthermore, to the extent that a Disco maintains an affiliation with a corporate counterpart that has personnel or information developed during its tenure as a part of the regulated monopoly, that affiliate would gain a large competitive advantage in the use of its information, marketing, engineering and other expertise in the competitive market. The Department called for equal access which should apply to the provision of customer information in the possession of the Disco, including both data on individual customers (released with their permission) or statistical market data. While regulators can follow financial transactions through the books of account, they would have more difficulty discovering and tracing the transfer of valuable customer or market information through affiliate relationships, even with so called "fire walls".<sup>16</sup> To cite but one example, a retail affiliate could have knowledge that certain customers or areas have historically had voltage problems, and use this information to target such customers with customized proposals for on-site distributed generation, and to close those sales.*

*The regulation of utilities which are no more than "functionally unbundled" would not only be expensive but its effectiveness highly dubious. The Department's rules would have to provide for thorough and aggressive regulatory review of all affiliate transactions and potentially anti-competitive behavior on the part of the monopoly entities and all affiliates. Otherwise, non-affiliated competitors may be discouraged from investing in a market where they perceive a risk of favoritism of affiliates by Discos. Those which do enter the market would bombard the Department with accusations of self-dealing by Discos whenever their affiliates appear to win substantial market share. Despite the intensity of its pursuit, even when coupled with antitrust actions, the regulatory oversight of the Department could not possibly operate quickly enough and with sufficient forcefulness and sanctions to keep up with the speed, resourcefulness and pervasiveness of unregulated market operations.*

*Prior to voluntary divestiture, affiliates should be regulated and required to price all power sold within each Disco's distribution territory at the spot price. If utilities desire to maintain affiliation among competitive business units and regulated Discos, then their generation should remain regulated in this way when delivered to the Disco's customers.*

*DOER emphasizes that the separation of ownership presented in Power Choice should be a voluntary restructuring. Divestiture of competitive functions is not required by Power Choice nor does it need to be ordered by the Department. Such corporate separations happen continuously in the marketplace of competitive, non-monopoly companies and should not be considered as a burden that can only be imposed by regulation. Rather, utilities may voluntarily propose separation arrangements as part of negotiated settlements.*

*The risks of abuse of vertical market power are ubiquitous. It is not incumbent on regulators, customers or competitors to prove that it will exist and be abused. Rather, it should be incumbent on utilities which do not voluntarily divest all competitive functions to rebut the presumption that all reasonable efforts should be made to avoid anti-competitive behavior through complete legal and financial separation. Likewise, the burden should be on the proponents of the filed utility plans to show how ratepayers are otherwise fully protected from higher prices that would be expected to result from potential market abuses.*

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<sup>16</sup> The acceptance of firewalls for anti-trust settlements as suggested by MECo's witness Gilbert (DPU 96-25 Testimony of Gilbert, p. 35), does not prove they work nor are preferable in this situation of introducing competition into a current monopoly industry.